

A STUDY OF BUDGET CHARACTERISTICS
IN THE ANNUAL BUDGETING PROCESS:
THE CASE OF UNIVERSITI SAINS MALAYSIA

By

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I dedicate this work...

to my late father

to my beloved mother and wife, Ana
for their encouragement, patience and continuous support

and

to my lovely daughter, Umaira
to my respected sister, Inas

for their tolerance and understanding

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ABSTRAK

Kajian ini bertujuan untuk menyelidik hubungkait diantara ciri-ciri belanjawan iaitu penyertaan belanjawan, komunikasi belanjawan, komitmen belanjawan dan pengukur dan pemantauan dan pembolehkan bersandar iaitu persembahan belanjawan. Kajian ini juga melihat bagaimana komitmen belanjawan dapat mencelah hubungan ini. Banci telah dijalankan ke atas semua ketua Pusat Tanggungjawab di Universiti Sains Malaysia meliputi ketiga-tiga kampus. Data yang dikaji ialah daripada 64 responden. Hasil kajian menggunakan model yang telah dicipta oleh Baron dan Kenny (1986) menunjukkan bahawa tiada hubungan yang signifikan diantara pembolehkan tak bersandar dan pembolehkan bersandar. Walaubagaimanapun kajian ini telah menemui hubungan yang signifikan diantara komitmen belanjawan iaitu pembolehkan pencelah dan pembolehkan bersandar. Kajian ini juga menemui dua daripada pembolehkan tak bersandar iaitu komunikasi belanjawan dan pengukur dan pemantauan mempunyai hubungan positif yang signifikan dengan pembolehkan pencelah.

ABSTRACT

This study attempt to investigate the relationship between budget characteristics that is budget participation, budget communication, budget clarity and measure and monitor and the dependent variable which is budget performance. We also looked at how budget goal commitment can intervened this relationship. Census was carried out to all of head of RC in Universiti Sains Malaysia comprising all three campuses. The data being analyzed is from 64 respondents. The finding using the model stipulated by Baron and Kenny (1986) shows that there is no significant relationship between the independent variable. However we found that there is a significant relationship between budget goal commitment which is the intervening variable and the dependent variable. We also found out that two of the independent variable that is measure and monitor and budget communication has a positive significant relationship with the intervening variable.

Glossary

RC	Responsibility Centre
MBS	Modified Budgeting System
USM	Universiti Sains Malaysia

Chapter 1

INTRODUCTION

1.0 Background of Study

According to Xavier, (2001) the budget is basically a plan of what the government intends to do in a budget year and how it proposes to raise and use the resources for this purpose. Budgets are products of the budgetary process. A budget, in the context of the government, is a plan that sets out the objectives and strategies of the government in a budget year, the programmes and activities that would be carried out to execute the strategies to achieve the overall objectives, the respective objectives of these programmes and activities that reflect the disaggregation of the overall objectives of the government, the revenue projected to be collected to finance the expenditure in carrying out the programmes and activities and performance targets – in terms of the delivery of services in the right quantity, quality and in a timely and cost effective fashion- that would need to be achieved to meet the sub objectives and, thereby, the overall objectives of the government.

Xavier (2001) then, commented on the present budgeting system in Malaysia. He claimed Modified Budgeting System (MBS) seeks to revitalize the budget process and it took shape at a time when significantly budgetary changes were taking place in the world. These reforms represented a shift in the public sector management paradigm from the progressive public administration to new public management. Under the new paradigm, budgeting and accountability were no longer input focused. They were to be output oriented. In design, MBS is to affect this paradigm shift and to champion budgetary planning and control and accountability by outputs.

Xavier (2001) continued by stating in the past, the Treasury did call for budget restraints and did impose fiscal limits upon agencies. For example, for the 1988 and 1989 budgets, the Treasury had directed agencies to limit their budget requests to the average of the allocations of the previous three years respectively. This total limit for the federal government would work out to RM 20 billion for 1988 and RM 21 billion for 1989. However, the totals requested by all agencies were RM 25 billion in 1988 and 1989 respectively. These totals were 23% more than the respective ceilings.

He then claimed as rational actors, the generality of the ceiling did not prevent the agencies from asking for more. The input-focused budget process that went by needs and not performance. The treasury had to prune budget submissions to affordable levels. The resultant haggling and arbitrary cuts over line items by the Treasury made resource allocation non-rational. This rationality even made top management to realize the futility of its involvement in the budget exercise and made it relegate budgeting to lower management.

He further claimed that MBS seeks to change all that discipline and rationality are to be imported into the budget process by explicitly quantifying a binding expenditure limit for each agency. Top management participation would, thereby, be made inevitable.

Employee participation in the budget-setting process has been widely studied, and it is thought to have both attitudinal and behavioral consequences. Empirical research conducted in the past three decades has generally shown a positive association between participation and employees' satisfaction with their job and supervisors and

favorable attitudes toward the budget (Murray & Dennis 1990). They added, however, the impact of participation on employee or work unit performance remains clouded due to diverse empirical findings. For example, Milani (1975) detected a number of insignificant associations between budgetary participation and performance, while Brownell and McInnes (1986) found a strong association between these two variables.

Hence this study would substantiate the study conducted by William, Macintosh and Moore (1990) whereby the effect of budget communication, budget clarity, measure and monitor and budget communication towards budget goal commitment in achieving the performance which is known as budget spending in the public sector.

Walad (2003) studied the relationship between budget behavior and performance of the head of secondary school in Malaysia. In his study he looked at the budget behavior namely budget participation, budget manipulation, personal attention toward budgeting and budget assessment against the performance of management. In his framework organizational commitment intervened the budget behavior and performance of management relationship.

1.1 Research Problem

This study will investigate the budget characteristics during the process of annual budget preparation at each of the responsibility center in Universiti Sains Malaysia. Over the years spending on operational activities had grown tremendously and it seems to be uncontrollable. It cannot be denied that this rapid increase in spending is due to expansion of academic and research activities. Furthermore, The Ministry of

Education had earmarked four universities to be recognized as the Research Universities. Universiti Sains Malaysia is one of them.

Spending in Universiti Sains Malaysia has increased tremendously in the last five years. Data on spending as compared to budget allocation from Bursary Department of Universiti Sains Malaysia shows that there are many cases of budget overruns from their original allocation. This imposed a serious problem because Universiti Sains Malaysia needs to obtain additional fund to finance those activities. This means that the fund allocated for another activity has to be channel to those unplanned activities. In the event where there are no additional fund to be allocated, Universiti Sains Malaysia has to apply to the Board of Directors to utilize their cash reserve. This reserve has been built since the existence of Universiti Sains Malaysia in 1969 from various source of finance such as dividends, student fees, and penalty and so on. Thus, it would not be appropriate and fair to finance those activities and allow the RC's budget to go beyond their original allocation just due to the fact that they had not budgeted those activities before the budgeting year.

Therefore the purpose of this study is to identify the effect of budget characteristics on spending among head of responsibility centres.

1.2 Research Questions

This research addresses the following questions to enhance our understanding on budget characteristics in Universiti Sains Malaysia:-

1. What is the current state of spending in Universiti Sains Malaysia?

2. How budget goal commitment intervene the relationship between budget characteristics and spending?
3. How budget characteristics influence the spending by the head of RC?
4. How budget goal commitment can affect the budget variance?

1.3 Research Objectives

The proposed research is intended to investigate the Budget Characteristics namely budget communication, budget clarity, measure and monitor and budget participation during the budget preparation process in Universiti Sains Malaysia and how it could have an impact towards the budget spending as compared to budget allocation. These study would also attempt to establish whether goal commitment do intervene the relationship between budget characteristics and budget spending.

Specifically, the objectives of the study are as follows:-

- I. To identify the relationship between budget participation, budget clarity, budget communication and measure and monitor with performance. i.e. budget spending in Universiti Sains Malaysia.
- II. To examine the influence of budget goal commitment on relationship between budget characteristics with performance. i.e. budget spending in Universiti Sains Malaysia.

1.4 Significance of Study

1.4.1 Theoretical Contribution

This study would able to contribute in this field as such

- I. It strengthens previous study in exploring the relationship between the head of responsibility center's budgeting behavior and their performance. i.e. budget spending. All this while performance focuses at other aspect such as departmental goals, manager's job performance, organizational performance and managerial motivation and attitudes.
- II. It introduces the budget goal commitment as the intervening variable between budget characteristics and budget spending. Previous studies such as Chong and Chong (2002) looks at the budget goal commitment that intervene the relationship between budget participation and job performance. Wentzel (2002) introduces budget goal commitment similar to Chong and Chong (2002). Walad (2003) in his framework employ budget goal commitment as an intervening variable between budget behavior and management performance.

1.4.2 Practical Contribution

This study would enhance the understanding of Budget Characteristics during the budget preparation process. It would also suggest area of improvement that USM can embarked on as far budgeting is concern. In addition, it would also divulge the level of understanding of head of responsibility center with regards to Modified Budgeting System. Finally this study would gauge whether head of responsibility center had fulfill the Vice Chancellor's aspiration which is to do more with less (Vice Chancellor's New Year's Speech, 10 Jan 2004)

1.5 Definitions of Variable

Brief definitions of variable are as follows:

1. Budget Participation

Budget Participation means an involvement in the budget preparation process such as expressing opinions, making necessary changes and influence during the budgeting process.

2. Budget Communication

Budget communication is the formal or informal communication between superior and subordinate during budget preparation process. This includes working with subordinates and superiors during budget preparation process.

3. Budget Clarity

Budget clarity gauges the level of understanding of MBS by the head of RC. It also incorporates how far the budget objective or targets explained what to be achieved in the following year.

4. Measure and Monitor

Measure means steps taken to make comparisons between actual and budgeted results which are also known variances. Monitor refers to the steps taken to ensure actual results do not derail from the targeted results. This includes actions taken to correct causes of budget variances and submitting explanations reasons for the large budget variances.

5. Budget Goal Commitment

Goal commitment refers to how committed the head of RC in achieving the budget objectives. It also explains how serious the head of RC look at the budgeting process.

6. Budget Spending

Budget spending refers to the actual expenses incurred for activities under the operational budget allocated by Universiti Sains Malaysia. It includes the non salary component (operational) and purchase of assets.

1.6 Organization of Remaining Chapters

This study is organized into five chapters. Chapter 1 introduces the subject matter, states the research objectives, explains the research problem and formulates the research question. Chapter 2 highlights the previous studies and their findings on the budget communication, participation, clarity, measure and monitor, budget goal commitment and budget spending. Chapter 3 exhibits a conceptual model, the methodology including the research site, sample and procedure, measures and statistical analyses employed. In chapter 4, the results of the various statistical analyses are presented. Chapter 5 conclude the study, discusses survey findings and some limitations. It also provides implication and gives some suggestions for future studies in this field.

Chapter 2

LITERATURE REVIEW

2.0 Introduction

This section will discuss and review as follows

1. Literature review that will identify and to determine the dimension of budget related behavior. It will also explain the definition, concept and established the importance of budget related behavior in determining budget spending.
2. This literature review would also identify and determine the dimension of budget goal commitment. It will then discuss the definition, concept and established the importance of budget goal commitment as the moderating variable.

2.1 Introduction to Public Budgeting

As stated by Hogue in his book, *Theoretical Approaches to Public Budgeting*, a significant development in the intellectual history of the 20th century has been explicit recognition by economists, politicians and the public at large of the importance of government in the operation of the economy. The public budget generally reflects the policy of the government toward the economy. Public budget is a forecast of governmental expenditures and revenue for ensuing fiscal year.

He then argued that the difficulty of discussing budgeting as a policy process lies basically in the difference between discussing private sector companies and government budgeting. Commercial practice is governed by series well-defined rules, and firms are required to produce a balance sheet, a profit and loss account and to monitor their cash flow carefully. On the other hand the accountability of government, even in a well-developed democracy, is in reality considerably less acute, or certainly

less clear, than that of companies to their shareholders or individuals to their various creditors. As a result, public budgeting is frequently of lower quality than is the norm in the private sector. Forecast of receipts and expenditures are often wildly at variance with reality; changes to accounting practices are sometimes made for cosmetic political purposes and certain distinctions, such as those between capital and current expenditure, are frequently blurred deliberately.

In the study by Kotze (1979), he argued that it may therefore be stated that a public budget is an instrument at the disposal of legislative authority. It enables to guide the economic, social, political and other activities of a community in a certain direction in order to realize predetermined goals and objectives, the results of which are not always quantifiable. The budget also contains all of the measures needed to subordinate the executive authority as the representative of the voters and taxpayers. The features of a public budget ensure the unique foundation on which its preparation, approval and execution are based. In public administration the budget serves as a decision making instrument by which priorities are set, goals and objectives are established, operating programs are compiled and control exercised. A budget document is the final product in the budget process and it should be suitable for consideration and approval by the legislative authority, while the execution of its contents should realize public objectives. The quality of the budget depends on the accuracy of the supporting data, the quality of the methods used and the expertise as well as the integrity with which it has been compiled.

On the other hand, Wildavsky and Caiden (1997), argue that to understand what was happened to budgeting in our time consider the radical changes in the norms of

desirable behavior that used to guide budgeters. According to them, budget emerged at the beginning of the nineteenth century as the result of reforms that replaced centuries of muddle and mismanagement with expenditure control based on norms of annularity, comprehensiveness, legislative appropriation, audit and balance. Public budgets today are evaluated against their long term implications, they consist of many different kinds of spending, and they unbalanced, uncertain and dependent on circumstances beyond their control.

2.2 Background of Universiti Sains Malaysia

The education sector in Malaysia is growing and expanding very rapidly. Up to now there are 17 public higher learning institutions in the country i.e. Universiti Malaya (UM), **Universiti Sains Malaysia (USM)**, Universiti Kebangsaan Malaysia (UKM), Universiti Putra Malaysia (UPM), Universiti Teknologi Malaysia (UTM), Universiti Utara Malaysia (UUM), Universiti Teknologi MARA (UITM), Universiti Malaysia Sarawak (UNIMAS), Universiti Malaysia Sabah (UMS), Universiti Pendidikan Sultan Idris (UPSI), International Islamic University (UIAM), Kolej Universiti Teknologi Tun Hussein Onn (KUITTO), Kolej Universiti Islam Malaysia (KUIM), Kolej Universiti Sains & Teknologi Malaysia (KUSTEM), Kolej Universiti Teknikal Kebangsaan Malaysia (KUTKM), Kolej Universiti Kejuruteraan Utara Malaysia (KUKUM) and Kolej Universiti Kejuruteraan Teknologi Malaysia (KUKTEM); 4 private higher learning institutions i.e. Universiti Petronas, Universiti Telekom, Universiti Tenaga and Universiti Tun Abdul Razak; and more than 500 private colleges.

Universiti Sains Malaysia was established in 1969 as Universiti Pulau Pinang, the second university in this country. It operates as a public higher education institution with its core activities in teaching and research. The Main Campus, with a land area of 239.47 hectares, is located 9.7 km from Georgetown, Penang. There are also two branch campuses. The Health Campus, with an area of 72.84 hectares, is situated 6.4 km from Kota Bharu at Kubang Kerian, Kelantan, while the Engineering Campus, with an area of 129.5 hectares, is located at Nibong Tebal, Seberang Perai Selatan (IDB loan proposal by Universiti Sains Malaysia, 2004)

2.2.1 Introduction to Annual Budgeting Process in Universiti Sains Malaysia

Taking an example of Universiti Sains Malaysia as a statutory body, they are required to submit their budget proposal to the ministry usually eight months before the new budgeting year starts. This budget proposal is a summary of budget proposals prepared by the responsibility center (RC) in Universiti Sains Malaysia and other universities too. After submitting the budget proposal to Ministry, the officers in the Ministry would combine all their activities under them as submit as the Education Ministry's budget proposal to be tabled in the parliament. Once this budget has been approved, all head of RC's are required to defend their budget proposal. This meeting which is known as the budget allocation session is chaired by the Vice Chancellor and the discussion would be concentrated on the non-emolument as well as the purchase of assets.

There are two main types of budget in the universities namely:

- a) Development Budget – This budget mainly is to finance the cost of constructing new buildings, major renovation of the existing building and purchasing

of huge and expensive equipments. This budget is allocated for a five years period and it's also known as the Malaysian Five Years Plan.

In order for this budget to be approved, University Science Malaysia must submit the list of project along with a comprehensive project detail for each project which is known as Project Brief. This project then would be approved by the Economic Planning Unit. Once the approval for each project is obtained and the budget is allocated, University Science of Malaysia can pursue with the intended project.

b) Operating Budget – This budget is to finance the typical year to year operating expenses. This budget is approved by the Education and Finance Ministry after University Science of Malaysia had defended their budget proposal. The budget is to pay off various expenses such as traveling expenses, rent, utilities bills, service rendered, assessment duty, insurance, minor renovation works, purchase of vehicle and small and medium scale of equipment. Under this budget, all RC would be allocated a sum of budget during the budget allocation session for them to run day their relevant RC and it's also meant to support the RC's academic programs.

The study, primarily concern with this operating budget because all the RC would be allocated a budget under this fund. Unlike the development budget only selected RC would be approved an amount to carry out their infrastructure development In the operating budget there are mainly three categories of expenditure. They are emolument, non-emolument and purchase of assets. For the purpose of this study, the emolument section is omitted because the head of RC has no direct control and information over this category of expenditure. This study will investigate based on the

non-emolument and purchase of assets environment because the head of RC could planned and forecast the expenditure in this categories.

The Government of Malaysia had regulated that all spending for the year must be budgeted before the new year begins through the preparation of the 'program agreement'. The program agreements detailed out the activities to be carry out for the coming years. It is a requirement for all RC to submit a detail 'program agreement' before the budgeting year start. Exceptions reports measure and monitor the activities in their programme agreements for which actual performance is inconsistent and outside the tolerable variance range. Programme agreements and exceptions reports comprise the basic budget submission of the ministries. A Programme agreement is a non-binding contract between the Treasury and the agency. It requires an agency to commit itself to a set of performance targets for a proposal level of funding that the ministry or department suggests for each activity in a programme (Xavier, 2001)

According to Xavier (2001) another report to be prepared is the exceptions report that complements programme agreements. The treasury requires agencies to submit end-of-year exceptions reports where performance to fall outside pre-determined variances ranges of targeted performance. These reports are to indicate the extent of the inconsistency; the reason for it; and the remedy to prevent its recurrence. This report would provide the following information for each indicator for which actual performance was outside the tolerable variance range:

- a) The target (with its tolerable variance range) and the actual performance. Such information will enable the Finance Ministry budget review officer to

get a feel of the extent to which actual performance has fallen outside the tolerable variance range.

- b) The reason for the variance in performance. If there are a number of possible reasons, only the most likely reasons are required.
- c) The action proposed or that have already been taken to prevent a recurrence of this inconsistent performance. If no action is to be taken, the ministry should indicate the reasons for the non-action.

With the program agreement, governments are encouraging all government agencies and statutory bodies to pre-plan their activities and their financial needs. In preparing the program agreement, budget participation, budget clarity, budget communication and goal commitment is a very important element to ensure a sound and exact budget proposal. After the operating fund had been allocated, it is the responsible of the head of RC to ensure that their actual expenditure is reflected from their original planning. Meanwhile, with the exception report, the deviation between planning and actual activities are capture which support the concept of measure and monitor as introduced Williams, Macintosh and Moore (1990)

2.3 Previous Study on Budget Characteristics

A budget is a detailed plan describing the use of financial and operating resources over a specific period. Companies set goals in order to guide decision. They then added measures are often necessary to determine whether goals are being achieved (Hill, Ingram, Albright & Baldwin; 2001).

A claimed by Drury (1995) claimed that various activities within a company should be coordinated by the preparation of plans of actions future periods. He added these detailed plans are usually referred to as budgets. However Bruns and Waterhouse (1975) defined budgets as financial plans and provide a basis for directing and evaluating the performance of individuals or segments of organizations. Through budgets, activities of different part of an organizations can be coordinated and controlled. Their research explores the interaction and relationship of one source of control, organization structure, with another source of control, budgets. They found that budget related behavior (BRB) is to be contingent upon various aspects of organization structure such as centralization, autonomy, and the degree to which activities are structured.

As argued by Kenis (1979) budget is not only a financial plan that sets forth cost and revenue goals for the responsibility centers within a business firms, but also a device for control, coordination, communication, performance evaluation and motivation. He added, most of the positive and negative effects of budgets on the attitudes, behavior, and performance of lower managers can be traced to the budgeting style of upper management. He stressed that the concept of budgeting style includes such budgetary goal characteristics as participation, goal clarity, feedback, budgetary evaluation, and goal difficulty.

Meanwhile according to Williams, Macintosh and Moore (1990), BRB has been identified as an important processual variable in terms of enabling organizations to achieve their goals. They claimed that the existing empirical BRB studies, however, had focused on private sector organizations in general (Swieringa & Moncur, 1972;

Bruns & Waterhouse, 1975) and manufacturing firms in particular (Decoster & Fertakis 1968; Swieringa & Moncur 1974; Merchant, 1981, 1984) and have ignored the public sector domain. They had identified that there are several potential reasons which might support expectations of systematically different degrees of importance of components of BRB in budgeting systems of public sector or organizations and that may have inhibited empirical research in this area. It is widely articulated, for example, that budget objectives, profit motives, proprietary versus political interests, users and the resource allocation process are differentiating elements in the budget systems of private versus public sector organizations.

Similarly Dunk and Lysons (1997) had strengthened this argument by stating that little research has explored the effects of the environment on the performance of departments in public sector organizations. Since pressure is being brought to bear on these organizations to be increasingly effective and accountable (e.g., Boger, 1994), research examining the effect of the environment in the public sector is warranted.

Alike Dunk and Lysons (1997), William et al (1990) had claimed that in addition to having limited focus on private sector organizations, many of the previous studies concerning managerial budgeting behavior (e.g. DeCoster & Fertakis, 1968; Bruns & Waterhouse, 1975; Swieringa & Moncur, 1974) have ignored performance. But as Otley (1980) argues, it is vital that research into accounting and information system includes the measurement of organizational effectiveness in. He added, a fundamental premise of management accounting is that there should be a design concordance between budgetary control and the goals of an organization as a whole (Hopwood, 1976, 1978; Otley, 1980; Cooper, 1983; Covaleski, 1985). The activities of each unit

are predicted upon the enhancement of objective in larger integrated whole. This implicates budgetary control in the serving of multiple perspectives to promote role of performance and effectiveness (Hongren, 1982).

Finally, Kenis (1979) presents an empirical examination of some effects of budgetary goal characteristics (dimension of budgeting style) on job related attitudes (job satisfaction, job involvement, job tension), budget related attitudes (attitudes toward budgets, budgetary motivation) and performance (budgetary performance, cost efficiency, job performance) of lower level management in industry.

2.4 Definition and Concept of Budget Characteristics and Budget Related Behavior

In this study the budget characteristics was selected as our independent variable because it is important and interesting to look at the relationship between the behavior of head of RC and the RC's spending level. This means that this study would try to look at behavior of head of RC during preparing the budget and whether this set of behavior can have a significant relationship when they actually engaged in the spending process.

Earlier empirical study investigated by Swieringa and Moncur (1972) whereby they defined budget oriented behavior as the ongoing, recurring activities and interactions of firm personnel brought about by the firm's use of budgets to allocate resources and to measure and evaluate performance. They then cited an example of a manager whereby in the formulation and preparation of budgets, a manager may spend a considerable time with his superiors; his subordinates and his fellow managers. The

managers in administering the budget and using it to evaluate unit performance, the manager may receive inquiries from his superiors about his unit's performance. He/She may make personal investigation of variances in his unit and he/she may work closely with his/her subordinates in taking corrective action. Moreover, he/she may express his/her opinions on budget matters, offer suggestions for improving the budget system and discuss specific budget items in informal conversations with superiors, subordinates, other managers and accounting and budget personnel.

Similarly Kenis (1979) claimed that communication of budgeted goals downward in an organization informs members of lower management about what upper management expects of them. Conversely, upper management learns about the accomplishment and problems of lower management through upward-flowing reports comparing budgeted goals with actual performance. He then continued by saying that budget information helps upper management to evaluate the performance of lower level managers and distribute rewards and punishments. In this context, budgets represent an important part of the organizations motivational system designed to improve managerial attitudes and performance.

In another study, Williams et al (1990) identified that BRB as those managerial activities, actions attitudes and interactions among managers and their tasks which occur on a regular basis and which are related to the system of budgetary controls (Decoster & Fertakis, 1968; Swieringa & Moncur, 1972, 1974; Bruns & Waterhouse, 1975). He added that the BRB literature has utilized the framework of traditional contingency theory (Burn & Stalker, 1961; Woodward, 1965; Lawrence & Lorsch, 1967; Pugh, 1969) to suggest that administratively oriented control strategies such as

budgeting which are found in complex decentralized or organizations, tend to be more formal in nature than informal and of an interpersonal nature. Within the formal framework it is argued that the interactive process of budgeting systems reflects budgeting behavior that places important on the achievement of budget plans, is participative, express formal patterns of communication, and is relatively inflexible to change (Bruns & Waterhouse, 1975; Merchant, 1981,1984)

Accordingly, Bruns and Waterhouse (1975) defined BRB as the activities, actions, and interactions of managers with each other and their tasks that relate either directly or indirectly to budget systems. Bruns and Waterhouse (1975) conceptualized and defined Budget related attitudes as affective feelings of managers towards budgets and budget related behaviors of themselves and others. They found that BRB could be described using 11 factors, including participation in planning, evaluation by budget, enabling features of budget, participation in budget systems, limiting features of budgets, support from budget, acceptance of methods, required explanation of variance, interaction with superior, difficulty in meeting budget and participation in feedback. Such behavior was found to be contingent upon various aspects of organizational structure such as centralization, autonomy, and the degree to which activities were structures. Their findings lead to the conclusion that there must be alternative organizational control strategies in different kinds of organization. An alternative strategy for control is to centralize decision making authority at higher levels within organization. They cited Child (1973) which claimed that maintaining control by centralizing decision making reduces the need for organization, systems, procedures and specialist personnel to operate administrative systems.

Later, Williams et al (1990) conceptualized budget character in a very similar way in a contingency study of BRB in public sector organizations. Their findings concerning the significant behavioral factors were very similar to those in private sector study by Bruns and Waterhouse (1975), suggesting that such behavior is similar in both private and public sectors. To facilitate analysis, the factors were categorized as (1) measuring and monitoring, (2) participation, (3) formal communication and (4) enabling change. In their study their dependent variable is departmental performance goal and thus it is expected that a linkage should exist between them and those four factors although empirical evidence is currently nonexistent. They had extended the analysis offered by Bruns and Waterhouse (1975) and concluded that there was evidence of support for the contingency notion of fit between budgeting behavior and departmental performance in the context of task interdependency.

2.4.1 Budget Participation in the Annual Budgeting Process

Hill, Ingram, Albright and Baldwin (2001) addressed that different leadership style on the part of top management can lead to different types of budgeting. Budget can be described as either top-down or bottom-up, as shown in Figure 2.1 below.

They then explained that top-down budgets that are established by management and then provided to lower levels of an organization for compliance. Bottom-up (participative budgeting) involve all levels of an organization working to achieve the organizational goals. In the government sector, the participation during the budgeting process can be seen as the non-participative budgeting whereby staff preparing the

budget would receive instruction on what to ask, the future activities of RC and the amount of money to ask.

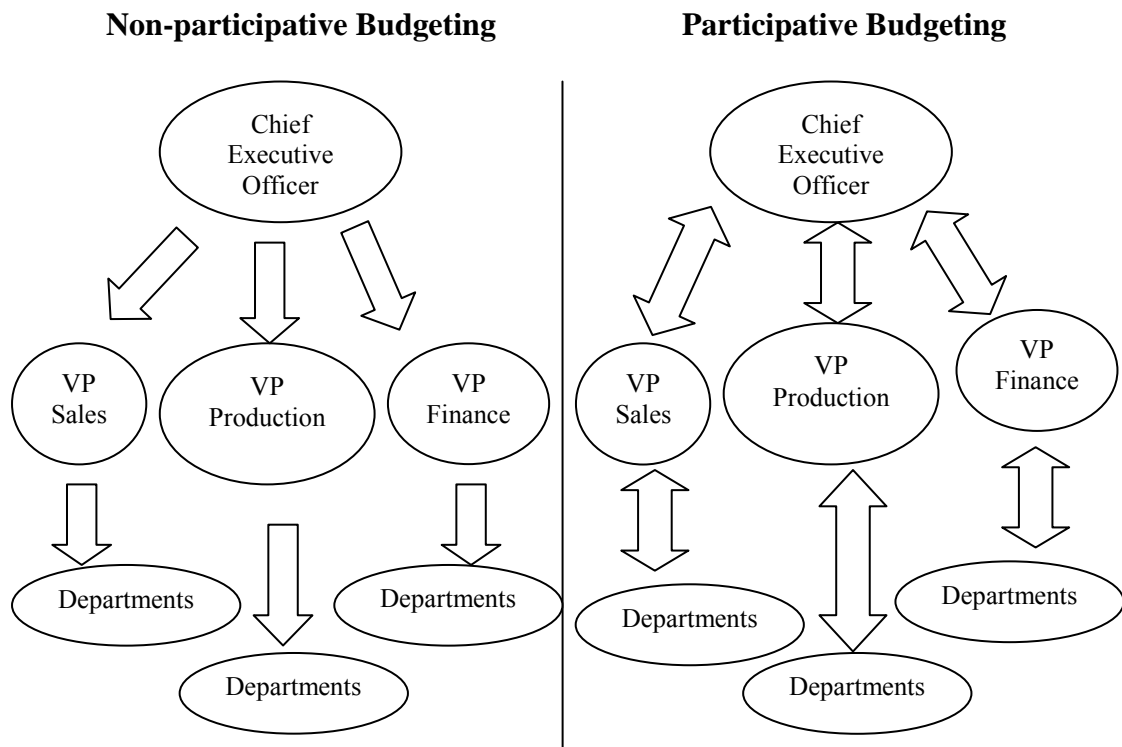


Figure 2.1: Participative and Non-Participative Environment

In this context, Brownell (1981) operationally defined participation as the amount of influence an individual had on a final budget which was jointly set.

According to Shields and Shields (1998), participative budgeting –usually defined in the accounting literature as a process in which a manager is involved with, and has influence on the determination of his or her budget – has been one of the most researched topics in management accounting for over 40 years. (Hopwood, 1976; Brownell, 1982a; Young 1988; Birnberg, 1990). They then developed the theoretical basis why participative budgeting exists is primarily rooted in economics,

psychological and sociological theories. (1) Economics; Since the economics literature assumes that a subordinate knows more about his or her task environment than does his or her superior, participative budgeting is modeled as being used by the superior to gain information-reduce uncertainty-about the subordinate's task and task environment (Christensen, 1982; Baiman & Evans, 1983; Penno, 1984; Kirby, 1991).

A consequence of this information sharing is that the superior is able to design and offer subordinate a more efficient, goal-congruent incentive contract which increases subordinate motivation to achieve the budget. Besides modeling how participative budgeting can be used to reduce horizontal information asymmetries by enabling the superior to gain information about subordinates' interdependent tasks and thus coordinate their budgets as argued by Kanodia, (1993). From psychological perspective (2); Participative budgeting research used psychological theories (Becker & Green, 1962; Ronen & Livingstone, 1975; Hopwood, 1976; Brownell, 1982a; Young, 1988; Murray, 1990) considers three mechanisms by which participative budgeting involving a superior and a subordinate causes effect-value attainment, cognitive, and motivation (Locke & Schweiger, 1975; Locke & Latham, 1990). For example value attainment is theorized to affect satisfaction and morale because the process (act) of participation allows a subordinate to experience self respect and feelings of equality arising from the opportunity to express his or her values. The other two mechanism, motivation and cognitive, are theorized to affect performance. In the case of motivational mechanism, it depicts the act of participation as increasing a subordinate's trust, sense of control, and ego-involvement with the organization, which then jointly cause less resistance to change and more acceptance of, and

commitment to, the budget decisions, in turn causing improved performance (Hopwood, 1976; Lawler & Rhode, 1976; Locke & Schweiger, 1979).

On the other hand sociology perspective pointed out that theories have been used to model how organizational context (e.g. environment uncertainty) and structure (e.g. decentralization, functional differentiation) are antecedents to participative budgeting. The theoretical underpinning of this research has been the contingency theory of organizations (Hopwood, 1976; Brownell, 1982a; Otley & Wilkinson, 1988; Fisher, 1995). This theory predicts that as an organization's external environment becomes more uncertain, it responds by increasing its differentiation (e.g. number and type of subunits) which consequently requires an increase in the use of integrating mechanism such as participative budgeting, to co-ordinate the actions of its subunits (Lawrence & Lorch, 1967; Brownell, 1982a)

As cited by Shields and Shields (1998) in their study, Argyris (1952) the first of many empirical evidence studies published on participative budgeting, investigated organizational and behavioral effects on participative budgeting on subordinate managers. The subsequent empirical research has been motivated by economic, psychological or sociological theories. These theories have been used by the subsequent studies to develop four types of empirical models of the effects of participative budgeting: (1) the model study has investigated how moderator variables affect the relationship between participative budgeting as an independent variable and dependent variable such as satisfaction, motivation and performance; (2) the direct effects of participative budgeting on dependent variables; (3) participative budgeting as an independent variable interacting with another independent variable to effect